purchaser has the burden of proving that the transaction was a bona fide sale. Purchases where the buyer and seller are related organizations are not bona fide.

(1) The cost basis of a facility and its depreciable assets acquired in a bona fide sale after October 1, 1985 is limited to the lowest of:

(a) Purchase price paid by the purchaser;

(b) Fair market value at the time of the sale;

(c) The seller's cost basis, increased by one-half of the increase in the consumer price index for all urban consumers, United States city average, all items, from the date of acquisition by the seller to the date of acquisition by the buyer, less accumulated depreciation recognized for cost reporting purposes; or

(d) The seller's cost basis, increased by one-half of the increase in the Dodge construction index from the date of acquisition by the seller to the date of acquisition by the buyer, less accumulated depreciation recognized for cost reporting purposes.

b. In a sale not bona fide, the cost basis of an acquired facility and its depreciable assets is the seller's cost basis, less accumulated depreciation recognized for cost reporting purposes as of the end of the report year immediately preceding the date of acquisition by the buyer.

c. The cost basis of a facility and its depreciable assets acquired by donation or for a nominal amount is the cost basis of the seller or donor, less accumulated depreciation recognized for cost reporting purposes as of the end of the report year immediately preceding the date of acquistion by the buyer or donee.

d. In order to calculate the increase over the seller's cost basis, an increase may be allowed, under paragraphs (c) or (d), only for assets with a historical cost basis established separately and distinctly in the seller's depreciable asset records.

e. For purposes of this subsection, "date of acquisition" means the date when ownership of the depreciable asset transfers from the transferor to the transferee such that both are bound by the transaction. For purposes of transfers of real property, the date of acquisition is the date of delivery of the instrument transferring ownership. For purposes of titled personal property, the date of acquisition is the date the transferee receives a title acceptable for registration. For purposes of all other capital assets, the date of acquisition is the date the transferee possesses both the asset and an instrument, describing the asset, which conveys the property to the transferee.

7. An adjustment may not be allowed for any depreciable cost that exceeded the basis in effect for rate periods prior to January 1, 1996.

8. A per bed cost limitation based on single and double occupancy must be used to determine the total allowable cost basis of buildings and fixed equipment for a facility with construction, renovation or remodeling.

   a. The per bed limitation basis for double occupancy must be calculated averaging the cost basis reported on the June 30, 1994 cost report, as adjusted by the consumer price index for all urban consumers, United States city average, all items, to June 30, 1995, for nonstate-owned facilities with construction of new occupancy space completed on or after January 1, 1990, and before July 1, 1994.

   b. The per bed limitation basis for single occupancy must be calculated using the limitation determined in subdivision a, multiplied by 1.34.

   c. The double and single occupancy per bed limitation must be adjusted annually on July 1 using the consumer price index for all urban consumers, United States city average, all items, for the twelve month period ending the preceding May 31.

   d. The per bed limitation in effect at the time a construction, renovation, or remodeling project is put in service must be multiplied times the number of beds in double and single occupancy rooms to establish the maximum allowable cost basis of buildings and fixed equipment.

   e. The cost basis of a facility's buildings and fixed equipment must be limited to the lower of the recorded cost of total facility buildings and fixed equipment or the per bed limitation.

   f. The per bed limitation is not applicable to projects started or approved by the state health council before July 1, 1994.

Section 19 - Interest Expense

1. To be allowable under the program, interest must be:

   a. Supported by evidence of an agreement that funds were borrowed and that payment of interest and repayment of the funds are required. Repayment of operating loans must be made within three years of the borrowing.

   b. Identifiable in the facility's accounting records.

   c. Related to the reporting period in which the costs are incurred.

   d. Interest expense must be necessary and proper for the operation, maintenance, or acquisition of the facility. "Necessary" means that the interest is incurred on debt made to satisfy a financial need of the facility and for a purpose reasonably related to resident care. "Proper" means that the interest is incurred at a rate not in excess of what a prudent borrower would be obligated to pay in an arm's-length transaction and is incurred on debt obtained from a lender not related to the borrower through common ownership or control except for funds borrowed in accordance with Section 22 - Funded Depreciation.

   e. Interest expense must not relate to funds borrowed to finance costs of assets in excess of the depreciable cost basis established at the time of purchase, construction, renovation or remodeling as recognized in Section 18 - Depreciation.

   f. If associated with borrowing for the purpose of acquiring assets as an ongoing operation in a bona fide sale, interest expense must be limited to the amount of interest associated with borrowing, occurring at the time of the sale, that does not exceed ninety percent of the cost basis as determined in Section 18.

   g. In a sale not bona fide, interest expense may not exceed the amount that would have been allowable had the sale not occurred.

   h. If associated with refinancing or refunding debt, interest expense associated with the original borrowing must have been allowable when the debt was initially incurred.

2. In cases where it is necessary to issue bonds for financing, any bond premium or discount must be amortized over the life of the bond issue.

3. Interest paid by the provider to partners, stockholders, or related organizations of the provider is not allowable as a cost. Where the owner loans funds to a facility, the funds are considered capital, rather than borrowed funds.

4. If a facility incurs interest expense because of late payments for resident services and charges a service charge or interest for late payments, such income must be offset against interest expense. If no interest expense is incurred by the facility because of late payments for resident services, service charges or interest paid must be offset against administration expenses.

5. For refinanced or refunded debt, the total net aggregate allowable costs to be incurred for all reporting periods may not exceed the total net aggregate costs that would have been allowed had the refinancing or refunding not occurred. Annual allowable costs will be limited to the lesser of the costs which would have been allowed had the refinancing or refunding not occurred or the costs associated with the refinancing or refunding plus the portion, if any, of adjustments not recognized in prior cost reporting periods.

6. Interest expense must be allocated between allowable and nonallowable expense based on the ratio of the principal balance of allowable debt to the principal balance of nonallowable debt at the time the debt was incurred except that the ratio may be adjusted to reflect principal payments on nonallowable debt made in excess of scheduled repayments, provided no funded depreciation or borrowed funds are used to make the excess principal payment.

Section 20 - Taxes

1. Taxes assessed against the provider, in accordance with the levying enactments of the several states and lower levels of government and for which the provider is liable for payment, are allowable costs. Tax expense may not include fines, penalties, or those taxes listed in Section 12 - Unallowable Costs.

2. Whenever exemptions to taxes are legally available, the provider is to take advantage of them. If the provider does not take advantage of available exemptions, the expense incurred for such taxes is not recognized as an allowable cost under the program.

3. Special assessments in excess of $1,000, which are paid in a lump sum, must be capitalized and depreciated. Special assessments not paid in a lump sum may be expensed as they are billed by the taxing authority.

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Section 21 - Startup Costs

1. In the first stages of operation, a new facility incurs certain costs in developing its ability to care for residents prior to their admission. Staff is obtained, organized, and other operating costs are incurred during this time of preparation which cannot be allocated to resident care during that period because there are no residents receiving services. Such costs are commonly referred to as startup costs. Actual allowable startup costs may be considered as deferred charges under the program and allocated over a number of periods which benefit from such costs. Where a facility has properly capitalized startup costs as a deferred charge, the startup costs will be recognized as allowable costs amortized over sixty consecutive months starting with the month in which the first resident is admitted.

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Section 22 - Funded Depreciation

1. Funding of depreciation is the practice of placing funds, including nonborrowed bond reserve and sinking funds, in a segregated account(s) for the acquisition of depreciable assets used in rendering resident care or for other capital purposes related to resident care. Other capital purposes include capital debt liquidation, such as principal payments for bonds and mortgages.

2. All provisions of this subsection must be met in order to qualify as funding of depreciation. If the provisions are not met, income earned on investments will be offset to interest expense.

   a. The action to fund depreciation must be approved by the appropriate managing body of the facility.

   b. The fund or funds must be clearly designated in the facility's records as funded depreciation accounts.

   c. Funded depreciation (total market value of fund) must be available (unless contractually committed as noted below) on an as-needed basis for the acquisition of the facility's depreciable assets used to render resident care, or for other capital purposes related to resident care. Loans made from funded depreciation do not alter the requirement that funded depreciation must be available.

   d. Income earned on investments in the fund must be deposited in and become part of the funded depreciation account.

   e. Deposits to the funded depreciation account must remain for six months or more to be considered as funded depreciation. Deposits of less than six months are not eligible for the benefits of the funded depreciation account. Investment income earned prior to elapse of the six month period will not be offset unless the deposits are actually withdrawn.

   f. Funded depreciation may not be restricted for a specific or future purpose.

   g. When a provider invests or transfers the assets of the fund to a home office of a chain organization or the motherhouse or governing body of a religious order or to other related parties, these assets are considered to be the facility's funds and are subject to all provisions of this section.

3. Total funded depreciation from deposits in excess of accumulated depreciation on resident-related assets will be considered as ordinary investments and the income therefrom will be used to offset interest expense.

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4. Withdrawals for the acquisition of capital assets, the payment of mortgage principal on these assets and for other capital expenditures are on a first-in, first-out basis. Withdrawals for general operating purposes or for loans to the general fund are made on a last-in, first-out basis.

5. The facility may borrow from funded depreciation to obtain working capital for normal operating expenses used for resident care. In addition, the facility may borrow from funded depreciation accounts of related nursing and hospital facilities if the funded depreciation accounts of the related facilities are maintained in accordance with HCFA regulations. The interest incurred by the general fund is allowable provided the loans are necessary and proper, and provided the funds withdrawn have met the six month funding requirement. If the funds withdrawn do not meet the six month funding requirement, interest paid on the loan is not an allowable cost.

6. Interest paid by the general fund to the funded depreciation account is not an allowable cost if the facility borrows the funds to acquire depreciable assets. The facility is expected to use funded depreciation for that purpose.

7. Deposits of funds into the funded depreciation account must be first applied to reduce loans outstanding from the funded depreciation account to the general fund. Until such loans, including related-party loans, are repaid in full, funds deposited in the funded depreciation account will be considered as repayments on the loans and any subsequent interest expense of the general fund to the extent of the repaid loans is not allowable.

8. Available funded deprecation must be withdrawn and used before resorting to borrowing for the acquisition of depreciable assets or other capital purposes. Because it is frequently difficult to time a bond offering or other borrowing to coincide with the exhaustion of available funded depreciation, it is sufficient if available funded depreciation is contractually committed to and expended during the course of construction.

9. Funds are considered available unless committed, by virtue of contractual arrangements, to the acquisition of depreciable assets used to render resident care, or to other capital purposes. Borrowing for a purpose intended by funded depreciation is unnecessary to the extent funded depreciation is available. Thus, interest expense for borrowing up to the amount of available funded depreciation is not an allowable cost.

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10. When funded depreciation is used by the facility for other than the acquisition of depreciable assets, other capital purposes related to resident care, or loans to the general fund for current operating costs, the income earned on these funds while on deposit in the funded account will be adjusted in the report year the withdrawal was made. The adjustment will include all offsets not made in prior reporting periods for earnings applicable to these funds.

11. Borrowing for a purpose for which funded depreciation account funds may have been used makes the borrowing unnecessary to the extent that funded depreciation account funds were available at the time of the borrowing. Available funds in the funded depreciation account, to the extent of the unnecessary borrowing, are tainted funds. Interest expense incurred on borrowing for a capital purpose is not an allowable cost to the extent that funded depreciation account funds were available at the time of the borrowing.

12. A provider may remove the unnecessary characterization of borrowing, and thereby cure tainted funded depreciation, by using the tainted funds for a proper purpose described in subsection 1. Any funded depreciation that existed at the time of the unnecessary borrowing and is not classified as tainted must be used before any of the tainted funds.

13. When only a portion of the borrowing is considered unnecessary under subsection 11, subsequent repayments of the borrowing from general funds must first be applied to the allowable portion of the borrowing and then, when all of the allowable borrowing is repaid, to the unallowable portion of the borrowing. When funds from the funded depreciation account are used for repayment of the unnecessary borrowing, an equivalent amount of tainted funds is cured without regard to the provisions of subsections 11 and 12. Where general funds are used to pay for the unallowable borrowing after the necessary borrowing has been repaid, an equivalent amount of tainted funded depreciation is cured without regard to the provisions of subsections 11 and 12.

Section 23 - Rate Calculations

Each cost category actual rate is calculated using allowable historical operating costs and adjustment factors, as provided for in Section 24 - Adjustment Factors for Direct Care, Other Direct Care and Indirect Care Costs, divided by standardized resident days for the Direct Care cost category and resident days for Other Direct Care, Indirect Care and Property cost categories. The actual rate as calculated is compared to the limit rate for each category to determine the lesser of the actual rate or the limit rate. The lesser rate for Direct Care is then multiplied times the weight for each classification in Section 32 - Classifications to establish the Direct Care rate for that classification. The lesser of the actual rate or the limit rate for Other Direct Care, Indirect Care and Property costs and the adjustments provided for in Section 25 - Rate Limits and Incentives are then added to the Direct Care rate for each classification to arrive at the established rate for a given classification. Rate calculation instructions and an example are found in Appendix B.

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